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Supreme Court of the United States

OCTOBER TERM, 1936.

No. 588.

HENRY E. OPPENHEIMER,

Petitioner,

—against—

THE HARRIMAN NATIONAL BANK AND TRUST COMPANY OF THE CITY OF NEW YORK, *et ano.*,

Respondents.

No. 670.

THE HARRIMAN NATIONAL BANK AND TRUST COMPANY OF THE CITY OF NEW YORK,

Petitioner,

—against—

HENRY E. OPPENHEIMER,

Respondent.

ON CROSS WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE HARRIMAN NATIONAL BANK AND TRUST COMPANY OF THE CITY OF NEW YORK, RESPONDENT IN NO. 588 AND PETITIONER IN NO. 670.

On Cross Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit to review a judgment of that court (R. 132-133), revising a judgment of the United States District Court

for the Southern District of New York and granting judgment *sub modo* in favor of the petitioner, Henry E. Oppenheimer, and against The Harriman National Bank and Trust Company of the City of New York in an action at law on rescission of sale to recover from said Bank and its Conservator the purchase price of shares of the Bank's stock which the plaintiff was induced to purchase by fraud (R. 132-133).

Opinions Below.

The District Court filed no opinion. The grounds of its decision were stated orally from the bench at the close of the trial (R. 46).

The opinion of the Circuit Court of Appeals, reversing the judgment of the District Court (R. 111-116), is reported in 85 F. (2d) 582.

Jurisdiction.

The judgment was entered November 9, 1936 (R. 132-133). Cross writs of certiorari were granted February 8, 1937 (R. 135).

The jurisdiction to review the judgment complained of by writ of certiorari is conferred by section 240 (a) of the Judicial Code as amended by Act of February 13, 1925 (Title 28 U. S. C., §347 [a]).

Questions Presented.

1. May a shareholder in a national bank rescind his purchase of stock from the bank and thereby oblige the bank to acquire the stock?

2. Is a national bank liable for the misrepresentations of its officers in selling shares of its stock not

its property, when the bank was not enriched by the transaction?

3. May a shareholder in a national bank rescind his purchase after the insolvency of the bank and participate in the proceeds of an assessment levied by the Comptroller of the Currency upon the other shareholders?

4. Is a shareholder in a national bank barred by the insolvency of the bank from asserting a claim for fraud in the purchase of his stock against the receivership assets where claims of creditors have accrued since the purchase?

5. May a defrauded shareholder in an insolvent national bank share *pari passu* with the creditors in the distribution of the assets of such bank in liquidation?

Statutes Involved.

The validity of no statute is involved.

The questions presented require the consideration of various sections of the National Bank Act as constituting a statutory plan for the conduct of national banks and the regulation of the relations between the shareholders of such institutions and their depositors and creditors.

The sections of the National Bank Act will be referred to and set forth, when necessary, at the appropriate places in the discussion which follows.

Statement.

Action at law by Henry E. Oppenheimer as plaintiff* against The Harriman National Bank and Trust

* Inasmuch as each party is both a petitioner and a respondent, we shall, for convenience, refer to Oppenheimer as "the plaintiff".

Company of the City of New York and Henry E. Cooper as Conservator of The Harriman National Bank and Trust Company, defendants, to recover the purchase price of shares of the Bank's stock which plaintiff was induced to purchase by fraud.

Plaintiff, who was at that time and now is a depositor in the Bank, purchased on November 1, 1930, 10 shares of the Bank's capital stock and received a certificate for the shares (R. 3-5).

The purchase was induced by representations as to the value of the shares made by one Williamson, a vice president of the Bank (R. 10-13).

The stock sold to plaintiff was the property of its affiliate, the Harriman Securities Corporation,* and the proceeds of the sale, less $100 commission, were credited to the Securities Corporation on the Bank's books (R. 32-34, 46, 112-114).

Plaintiff sold two shares of the stock in May, 1932 (R. 15). He received three dividends paid respectively in January and July, 1931, and January, 1932 (R. 15).

On March 3, 1933, the Bank was closed by reason of the bank holiday and never reopened. It was then insolvent (R. 34). A conservator was appointed on March 13, 1933, and a receiver on October 16, 1933.

During the period after plaintiff acquired the shares, claims of new creditors accrued against the Bank in excess of ten million dollars (R. 34, 38).

In May, 1933, two months after the Bank was closed and two and one-half years after plaintiff had acquired the stock, he read in a newspaper that an

* The Securities Corporation was organized for the purpose of holding and dealing in securities (R. 90). Its stock was held by trustees under an agreement (R. 89-95) by which the stockholders of the Bank were entitled to a beneficial interest in proportion to their holdings of Bank stock, that fact being endorsed on the certificates of Bank stock (R. 50).

action had been brought against the bank by another stockholder charging fraud in the sale of shares of the Bank's stock (R. 18). Thereupon plaintiff tendered to the conservator the remaining 8 shares of stock owned by him and demanded payment of the purchase price (R. 19-20, 51-52). The conservator rejected the demand and the present action was begun on May 31, 1933 (R. 1).

The trial was before a judge and jury. When both sides rested, each moved for the direction of a verdict and the trial judge, to whom the determination of the facts was thus submitted by both parties, found that the Bank was not enriched by the sale of the stock to plaintiff and that the officers who dealt with plaintiff had no actual or apparent authority to make the representations in connection with the sale of the stock (R. 46).

Accordingly, he directed a verdict in favor of the Bank and its co-defendant. The plaintiff did not move to go to the jury on any question of fact (R. 44, 45). Judgment was entered on the directed verdict (R. 7-8) and plaintiff appealed (R. 106-108).

The Circuit Court of Appeals held that the Bank's officers who had made the fraudulent representations were clothed with actual or apparent authority so as to bind the Bank by their representations (R. 114-115).

The Circuit Court of Appeals approved the rescission by plaintiff of the sale of the shares, and adjudged that plaintiff is entitled to recover the amount demanded in the complaint.

As plaintiff did not attempt to rescind until May, 1933, after the Bank had become insolvent and its doors were closed, the Circuit Court of Appeals held that he could not at that time "change his status

from that of shareholder to that of creditor to the detriment of general creditors" (R. 115-116).

The result was that although the Circuit Court of Appeals held that "rescission should be allowed as against the corporation", it ruled that the judgment to be entered should "give the plaintiff no claim entitled to share in the assets of the receivership until after payment of all who were creditors when the bank became insolvent" (R. 116).

Accordingly, the judgment of the District Court was reversed and the order for mandate directed "that judgment for the amount demanded in the complaint be entered against the defendant, The Harriman Bank and Trust Company of the City of New York, collectible out of the assets of the receivership after payment in full of all who were creditors when the said bank became insolvent" (R. 132-133).

The Circuit Court of Appeals dismissed the action as to the conservator because a receiver for the Bank had been appointed during the pendency of the action (R. 132).

Specifications of Errors to be Urged.

1. The Circuit Court of Appeals committed material error in holding that the demand of the plaintiff for rescission of the sale of shares of stock of The Harriman National Bank and Trust Company should be allowed as against the bank (R. 116).

2. The Circuit Court of Appeals committed material error in directing judgment in favor of the plaintiff entitling the latter to share in the assets of the receivership (R. 116).

Summary of Argument.

I.

A National Bank may not incur liability by contract or otherwise to retake shares of its own stock sold by it either as principal or agent.

II.

A National Bank may not be held liable for the misrepresentations of its officers in selling shares of its corporate stock not its property, when it is not enriched by the sale.

III.

The assessment on the shareholders of a National Bank may not be charged with the claim of a rescinding shareholder.

IV.

A shareholder in a National Bank is barred after insolvency from rescinding his purchase of its shares.

V.

A defrauded shareholder of a National Bank may not after insolvency share ratably with the depositors and creditors in the distribution of the Bank's assets.

POINT I.

A National Bank may not incur liability by contract or otherwise to retake shares of its own stock sold by it either as principal or agent.

A national bank cannot purchase its own stock except to prevent loss previously contracted.

> "Section 83. *Loans on or purchase by bank of own stock.* No association shall make any loan or discount on the security of the shares of its own capital stock, nor be the purchaser or holder of any such shares, unless such security

or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith; and stock so purchased or acquired shall, within six months from the time of its purchase, be sold or disposed of at public or private sale; or, in default thereof, a receiver may be appointed to close up the business of the association, according to section 192 of this title."

12 U. S. C. §83 (R. S. §5201).

Not only is a national bank prohibited from acquiring shares of its own stock except under the conditions defined by 12 U. S. C., §83, but it is also prohibited from withdrawing any portion of its capital.

"Section 56. *Prohibition on withdrawal of capital; unearned dividends.* No association, or any member thereof, shall, during the time it shall continue its banking operations, withdraw or permit to be withdrawn either in the form of dividends or otherwise any portion of its capital * * *. But nothing in this section shall prevent the reduction of the capital stock of the association under section 59 of this title."

12 U. S. C. §56 (R. S. §5204).

The only provision for reduction of capital is as follows:

"Section 59. *Reduction of capital by vote of shareholders.* Any association formed under this chapter may, by the vote of shareholders owning two-thirds of its capital stock, reduce its capital to any sum not below the amount required by this chapter to authorize the formation of associations; but no such reduction shall be allowable which will reduce the capital of the association below the amount required for its outstanding circulation, nor shall any reduction be made until the amount of the proposed reduc-

tion has been reported to the Comptroller of the Currency and such reduction has been approved by the said Comptroller of the Currency and no shareholder shall be entitled to any distribution of cash or other assets by reason of any reduction of the common capital of any association unless such distribution shall have been approved by the Comptroller of the Currency and by the affirmative vote of at least two-thirds of the shares of each class of stock outstanding, voting as classes."

12 U. S. C., §59 (R. S. §5143; Dec. 23, 1913, c. 6, §28, 38 Stat. 274; August 23, 1935, c. 614, §334, 49 Stat. 720).

These provisions of law constitute a statutory plan intended to prevent consequences which have been thus described:

"At the time this proceeding took place the Currency Act of 1863 had been superseded by the Act of June 3, 1864, which expressly repealed the former act. It is, therefore, by the provisions of the latter act that the conduct of bank associations must be governed, whether they were organized before or after they became a law. And in looking into this act we find these associations expressly prohibited from making any loan or discount on the security of the shares of their own capital stock. And so marked is the policy of Congress on this subject that it does not allow a bank to become the purchaser or holder of its shares at all unless absolutely necessary to prevent loss on a debt previously contracted in good faith, and not then for a longer period than six months. It is easy to see that if the power were given to a bank to loan money on the security of its shares, it would imply also a power to become the owner of its shares, and that Congress intended to guard against.

> These institutions were created to subserve public purposes, and not the mere private interests of their stockholders. And in no better way could this object be attained than by placing shareholders in their pecuniary dealings with the bank on the same footing with other customers. Besides how could the capital of the bank be kept available for active use if the shareholder who had pledged his stock for borrowed money should be unable to meet his obligation? To the extent of the debt the capital would be withdrawn and it is hardly possible that this could be the case for any length of time with the debts secured outside of the shares of the bank. But it is unnecessary to seek for the reason of this prohibition, as the provision concerning it is explicit and free from ambiguity."

Bank v. *Lanier,* 11 Wall. 369, 374-375.

> "The object and the policy of the statute in prohibiting a bank from purchasing outright its stock is to prevent the reduction of its outstanding stock, and the withdrawal *pro tanto* of its capital. *Bank* v. *Lanier,* 11 Wall. 374, 375."

Wallace v. *Hood,* 89 F. 11, 13.

The purpose intended to be accomplished by the various statutory provisions relating to national banks is that at all times the bank's stock shall be fully paid and that the bank shall have outstanding the amount of its capital stock for the security of its creditors and for the transaction of its business.

> "The Bank president could not lawfully acquiesce in the attempted rescission. A surrender of the stock by appellee and an acceptance of it by the bank would have constituted an unauthorized reduction in the capital stock of the banking association. The capital stock of a national bank-

ing association may be reduced pursuant to section 59, title 12, U. S. C. A., and not otherwise."

Schechter v. *Sherwin,* 81 F. (2d) 603, 605 (C. C. A. 7).

The provisions of the statutes and the expressions of the courts to which attention has been directed would seem to justify the following conclusions:

A national bank must have a fixed amount of stock, which must be paid in within six months after commencement of business (12 U. S. C. §51, 51c, 53*). The aggregate of such stock represents a fund to which the creditors may look in the event of insolvency to cover deficiency in assets (Id., §54**).

When the stock has been issued, the law contemplates that its quality of being outstanding shall not be affected otherwise than by the reduction to be accomplished under Revised Statutes §5143 (12 U. S. C. §59), except where acquisition of shares is necessary to permit realization upon a debt owing to the bank contracted prior to such acquisition. Even in a case falling within this category, the stock that is temporarily withdrawn must be put out again within six months under penalty of closing the bank.

In this state of the law, a requirement that the bank shall accept shares of its own stock as the result of invoking the doctrine of rescission would seem to involve consequences not permitted by the scheme of laws relating to national banks and in apparent violation both of their terms and policy.

Therefore, when demand was made upon the conservator to accept from the plaintiff, after insolvency of the Bank, the shares in question and pay the plaintiff the amount paid by him for such shares, it is manifest that the conservator could not legally com-

* Set forth in full in Appendices A, B and C hereto, pp. 51-53.

** Set forth in full in Appendix D hereto, p. 53.

ply with such demand, and it seems to be equally manifest that the court should not compel such compliance.

It would seem to make no difference whether the acquisition by a bank of its own stock was *ultra vires*, or, in the special circumstances in which the bank may purchase its own stock.

> "The purchase of this stock by the bank under the circumstances disclosed by the answer was doubtless *ultra vires*, but the purchase in question did not render the stock void. In purchasing it the bank made an unlawful use of its funds for which the officers concerned in the transaction could have been held responsible as for any unlawful act if the corporation had sustained damage; but in point of fact by the sale of the stock to the defendant that portion of its capital which had been dissipated by the purchase was restored by the resale and no loss seems to have been incurred."
>
> *Lantry* v. *Wallace*, 97 Fed. 865, 868. Approved 182 U. S. 536, 553.

The sale of stock acquired by a bank by purchase *ultra vires* does not render the sale unlawful, since it operates to restore that part of the capital which had been retired by the purchase.

> "The sale of the stock to the defendant after the bank had purchased the same was not unlawful since it operated to restore that part of the capital that had been retired, and to that extent repaired the wrong which might otherwise have been done to the bank's creditors."
>
> *Lantry* v. *Wallace*, 97 Fed. 865, 869, approved 182 U. S., pp. 553-4.

Therefore the purchaser of such stock from a bank cannot avoid payment of the stock assessment levied by the Comptroller under 12 U. S. C., §64.

> "We are at a loss to understand how this transaction on the part of the bank can operate to relieve the defendant from his liability as a stockholder in a suit brought by the receiver to recover a stock assessment which was levied solely for the benefit of corporate creditors."
>
> *Lantry* v. *Wallace*, 97 Fed. 865, 869, approved 182 U. S. at p. 553.

Since it is of no consequence, so far as the passing of title to the purchaser from the bank and the liability of the purchaser to pay the assessment which may be levied on the stock are concerned, whether the bank acquired the stock in a permitted or forbidden transaction, we have next to inquire whether the bank in disposing of the stock can render itself liable to retake it. That is the nature of the present action. This question is of continuing importance because it will survive the repeal of stockholders' double liability under the recent statutes (12 U. S. C., §64-a; Act of June 16, 1933, c. 89, §22, 48 Stat. 189; Act of August 23, 1935, c. 614, §304, 49 Stat. 708).

To require a national bank to retake shares of its stock because in selling the same the officers of the bank have made fraudulent representations would permit the bank to accomplish by indirection what apparently it is prohibited from doing directly.

It can hardly be contended that if a bank sold its stock under a repurchase agreement, the repurchase feature of the transaction would be valid (see *Norwalk* v. *Marcus*, 235 App. Div. [N. Y.] 211; aff'd 261 N. Y. 615, *infra*, pp. 17-21), and yet that is in effect what is accomplished by permitting rescission of

an executed sale of the bank's stock, on the ground that such sale was accomplished by fraudulent misrepresentations.

Revised Statutes, §5136, par. 7 (12 U. S. C., §24, par. 7), authorizes national banks to carry on a banking business and defines banking powers. Prior to the Act of February 25, 1927, c. 191, §2, 44 Stat. 1226, which amended R. S., §5136, par. 7, no direct reference was contained in the recitation of the corporate powers of such associations as to dealing in investment securities (*Awotin* v. *Atlas Exchange National Bank,* 295 U. S. 209, 212). By the statute referred to the business was recognized, but

> "limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person * * * or corporation, in the form of bonds, notes, and/or debentures, commonly known as investment securities. * * *"

By further amendments (Act of June 16, 1933, c. 89, §16, 48 Stat. 184, and Act of August 23, 1935, c. 614, §308, 49 Stat. 709), the corporate powers of national banks in the respect referred to were modified, as will appear by the following parallel columns showing the changes in R. S., §5136, par. 7, so far as we are concerned with them, viz:

> "Seventh: To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion; by loaning money on personal securities; and by obtaining, issuing and circulating notes according to the provisions of this title." (Revised Statutes §5136, derived from Act of June 3, 1864, c. 106, §8.)

[Added by 1927 Act]

"Provided, that the business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse

marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures, commonly known as investment securities, under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency

[Additions of 1927 as Changed by 1933 Act]

"The business of dealing in investment securities by the association shall be limited to purchasing and selling such securities without recourse,

solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities; Provided, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe • • • [followed by a limitation as to the amount]. As used in this section the term 'investment securities' shall mean marketable obligations evidencing indebtedness

[etc. as in 1927 Act].

[Same as further Changed by 1935 Act]

"The business of dealing in securities *and stock*• by the association shall be limited to purchasing and selling such securities *and stock*• without recourse, solely upon the

[etc. as in 1933 Act].

•Italics ours.

[followed by a limitation as to the amount] • • • ."	Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association of any shares of stock of any corporation • • • ."	Except as hereinafte provided or otherwis permitted by law, noth ing herein containe shall authorize the pur chase by the associatio for its own account o any shares of stock o any corporation • • • ."

It was obviously not intended by Congress under the last amendment (Act of August 23, 1935, c. 614, §308, 49 Stat. 709), which authorizes limited dealing in *stock*, to modify the provisions of Revised Statutes, Sec. 5201 (Title 12 U. S. C., §83), forbidding national banks to loan on or purchase their own stock.

It must be assumed, therefore, that the existing provisions of the National Bank Act, to which we have directed attention, which prohibit transactions in the stock of a bank (12 U. S. C., §83) and the withdrawal of its capital (12 U. S. C., §56), and which provide the only method by which reduction of capital may be effected (12 U. S. C., §59), were ample to accomplish the same prohibition on the incurring of contingent liabilities resulting from transactions in its own stock as was effected with respect to dealings in other securities by the amendments of Revised Statutes, Sec. 5136, to which we have referred.

In short, it is all part of a statutory plan, the nature of which is indicated by the decision of this Court in *Awotin* v. *Atlas Exchange National Bank*, 295 U. S. 209. In that case, the effort was to compel a national bank to retake securities which it had sold under a contract that violated Section 5136 of the Revised Statutes (12 U. S. C., §24, par. 7, as amended by the aforesaid Act of February 25, 1927, c. 191, §2, 44 Stat. 1226). It was sought to avoid the definite

prohibition contained in the statute by the claim that a quasi-contractual right could be based upon failure of consideration and also upon the theory of law which allows recovery where one party has been unjustly enriched at the expense of another. Neither theory prevailed.

The following language from the opinion of the court announces the doctrine which is equally applicable to the situation under discussion.

> "National banks are public institutions, and the purpose and effect of the statute is to protect their depositors and stockholders and the public from the hazards of contingent liabilities, attendant upon the assumption by the bank of the risk of loss by its customers, resulting from the permitted dealing in securities by the bank. The prohibition would be nullified and the evil sought to be avoided would persist, if, notwithstanding the illegality of the contract to repurchase, the buyer, upon tender of the bonds, could recover all he had paid for them. Such a construction of the statute is inadmissible."
>
> *Awotin* v. *Atlas Exchange Bank*, 295 U. S. 209, 214.

The necessity of maintaining the integrity of statutes relating to banks and intended to protect depositors and stockholders and the public against the hazards of unauthorized contingent liabilities, no matter what form such liabilities may assume, has been invoked to defeat that part of a contract by a bank selling its own stock which obliged the bank to repurchase the shares.

In *Norwalk* v. *Marcus*, 235 App. Div. (N. Y.) 211, affirmed 261 N. Y. 615 (without opinion), the plaintiffs appealed from a judgment which held void and

unenforceable that portion of a contract by a bank to sell stock at a stated price which provided for the re-purchase thereof at said price at any time within one year. It was urged that the agreement to re-purchase "was merely a provision for the rescission of the entire contract pursuant to which the plaintiffs purchased the stock" and was therefore not illegal; "that the respondent's violation of the Banking Law, if it has been a violation, does not constitute a defense to this action; that the agreement was *ultra vires* and not illegal and therefore, the plaintiffs having performed on their part, the respondent is estopped from asserting its own lack of authority".

It was also contended "that there was a failure of consideration and, therefore, the appellants are entitled to recover; that the rights of the appellants were fixed prior to July, 1930, the date of the alleged insolvency of the respondent, and, therefore, the insolvency subsequent to the commencement of this action is immaterial".

In passing upon these contentions, the Appellate Division expresses views regarding the effect of the provisions of the Banking Law of the State of New York which, since the provisions are identical with those contained in the National Banking Act, make the opinion directly applicable to the present controversy.

> "The respondent says that the alleged contract of the bank to repurchase shares of its own stock is unenforcible. It is claimed that the repurchase by a bank of shares of its own capital stock is inherently vicious and, if permitted, would deprive the creditors of the bank of the statutory security furnished by the assessment liability of stockholders upon the insolvency of the bank and would result, in effect, in an unauthorized

reduction of its 'capital stock or permanent capital' which is carefully guarded from impairment by express provisions of the Banking Law. It is further contended that it would operate, in many instances, to impair the legal reserves of the bank and would weaken and impair or, perhaps, destroy the security of the depositors and creditors through what may be described as an investment in its own securities, which automatically become worthless upon the failure or insolvency of the bank. It is also argued that it would enable the board of directors and officers to repurchase and practically retire, with the bank's own funds, sufficient of its capital stock to perpetuate their tenure and control and thus lead directly to minority management without check or restraint by a financially interested and diversified body of stockholders and directors.

"In dealing with stock corporations generally, the Legislature has found it necessary, in the interest of the public, to declare invalid agreements by corporations to repurchase shares of their own stock except out of surplus. (*Topken, Loring & Schwartz, Inc.* v. *Schwartz,* 249 N. Y. 206; *Cross* v. *Beguelin,* 252 id. 262.)

"Recognition of a broader public interest in the financial soundness and stability of banking institutions is reflected in a sterner legislative policy which prohibits a bank from using its assets, including surplus, in the purchase of its own stock, unless necessary to prevent a loss upon a debt previously contracted in good faith.

"Section 108, subdivision 6, of the Banking Law provides in part:

'§108. * * * A bank subject to the provisions of this article * * *

'6. Shall not make any loan or discount on

the security of the shares of its own capital stock, or be the purchaser or holder of any such shares, unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith, * * *.'

"The absolute character of the prohibition is emphasized by the succeeding language of the same subdivision which provides: '* * * and stock so purchased or acquired shall be sold at public or private sale, or otherwise disposed of, within six months from the time of its purchase or acquisition. * * *'

"Adequate supervision and publicity of operations of banking institutions have long been the aim and the public policy of this State. The statute in question represents an effort in that direction. To uphold the transaction upon which this litigation is founded would largely reverse this policy and seriously augment the risks and dangers to the public inherent in the business of banking.

"The entire contract is not illegal. That part providing for the sale of stock to the plaintiffs is valid and may be enforced. This proposition appears to have been passed upon in *Hoover Steel Ball Co.* v. *Schaefer Ball Bearings Co.* (90 N. J. Eq. 164); *Atwater* v. *Stromberg* (75 Minn. 277); *Knight* v. *Jeff Davis Banking Co.* (31 Ga. App. 440; 120 S. E. 696); *Jackman* v. *Continental National Bank* (16 F. [2d] 728).

"The most direct holding on the subject will be found in *Hoover Steel Ball Co.* v. *Schaefer Ball Bearings Co.* (*supra*). That case involved the sale of stock by a New York corporation under which the corporation agreed to repurchase the stock within one year at the option of the purchaser. A demand to repurchase and a refusal by the corporation were alleged. Upon the in-

solvency of the corporation and the appointment of a receiver, a claim was filed on the agreement to repurchase and the refusal of the receiver to pay the claim was sustained on the authority of New York and New Jersey cases.

"At page 169 the court said: '"We think this contract is of the class where the valid provisions may stand unaffected by the invalidity of another provision, and where the law leaves the parties *pro tanto* where it finds them."'

"At page 168 of the same opinion the court said: 'The claim on the part of the appellant that if such contract is unenforcible as against the corporation, the consideration has failed, and that the purchaser is entitled to be repaid the amount paid for the stock because it is unfair that the corporation should retain it, is answered by the Supreme Court of Michigan in *McIntyre* v. *E. Bement's Sons* (146 Mich. 74), 109 N. W. Rep. 45, 47, in the following language: "But the promise of such a corporation to buy its own stock, if under any circumstances valid, must be considered as made and accepted with the understanding that the shareholder may not, in the face of insolvency of the company, change his relation from that of shareholder to that of creditor, escaping the responsibilities of the one and receiving the benefits of the other;" and by the Circuit Court of Appeals for the Sixth Circuit, in *Allen* v. *Commercial National Bank of Detroit* (191 Fed. 97) in the following language: "To hold that the contract with the corporation to repay is invalid, but that Allen may demand repayment because of the failure of the expected consideration, is to accomplish by indirection the forbidden result."'"

Norwalk v. *Marcus*, 235 App. Div. (N. Y.) 211, 212-214.

An attempt to require The Harriman National Bank and Trust Company of the City of New York to take back its own shares because purchased on misrepresentations was defeated in *Goess* v. *Ehret*, 13 F. Supp. 630 on the authority of the doctrine announced in the *Awotin* case. The language of the District Court is as follows:

> "Defendant purchased 100 shares of the stock of the bank on certain misrepresentations made by Harriman. These shares of stock sold to the defendant were sold out of the Harriman Securities Corporation's Suspense Account. The amount of the price was credited to the Securities Corporation.
>
> "Defendant by way of relief requested that the bank take back the shares of its own stock and pay to the defendant the purchase price of these shares. This relief cannot be granted. *Awotin* v. *Atlas Exchange Nat. Bank*, 295 U. S. 209, 55 S. Ct. 674, 79 L. Ed. 1393.
>
> "The bank was not permitted to sell the stock. If it attempted to do so, the person dealing with it would have no recourse for any loss that might occur. There can be no relief in this case."
>
> *Goess* v. *Ehret*, 13 F. Supp. 630. For grounds of affirmance see *Goess* v. *Ehret*, 85 F. (2d) 109.

In *California Bank* v. *Kennedy*, 167 U. S. 362, this Court considered the power of a national bank to acquire 990 shares of stock of a savings bank with resultant liability as share-holder of the latter which had become insolvent. The question before the Court was thus stated by Mr. Justice White (p. 366):

> "1st, do the statutes of the United States, Rev. Stat. §5136, *et seq.*, relating to the organiza-

> tion and powers of national banks, prohibit them from purchasing or subscribing to the stock of another corporation? and, 2d, if a national bank does not possess such power, can the want of authority be urged by the bank to defeat an attempt to enforce against it the liability of a stockholder?"

After holding that "the United States statutes relative to national banks constitute the measure of the authority of such corporations, and that they cannot rightfully exercise any powers except those expressly granted, or which are incidental to carrying on the business for which they are established", the Court found that "a national bank does not possess the power to deal in stocks" because "The prohibition is implied from the failure to grant the power." (pp. 366, 367). The Court also observed (p. 367):

> "On behalf of the plaintiff below it was admitted at the trial that the stock of the savings bank was not 'taken as security or anything of the kind,' and it is not disputed in the argument at bar that the transaction by which this stock was placed in the name of the bank was one not in the course of the business of banking for which the bank was organized."

Having found that dealing in stock was "entirely outside of the powers conferred upon the bank, and was in no wise the transaction of banking business or incidental to the exercise of the powers conferred upon the bank" (p. 370), the Court concluded that the California National Bank was not estopped by accepting stock dividends from asserting its want of authority to purchase the stock in defense of an action against it as a share-holder.

See also:

Concord First National Bank v. *Hawkins*, 174 U. S. 364;

Shaw v. *National German-American Bank*, 199 U. S. 603, affirming 132 Fed. 658;

First National Bank v. *Converse*, 200 U. S. 425;

Merchants' Nat. Bank v. *Wehrmann*, 202 U. S. 295.

We conclude our submission on this phase of the argument with the following observation. The powers of a national bank are measured by "the statutory grant; and powers not conferred by Congress are denied" (*Texas & P. R. R. Co.* v. *Pottorff*, 291 U. S. 245, 253). The sale of stock, and particularly of its own capital stock, by a national bank is not part of its regular business, and is permissible only in exceptional instances. It requires no further citation of authority to demonstrate that a national bank, limited in acquiring its own stock to the single instance of preventing loss upon a previously contracted debt, may not agree, upon selling its own stock, to rescind the sale and take back the stock if its value is not as represented. And as it cannot create by express contract a liability to take back its stock if the representations made are untrue, it would be strange, indeed, if it could be held to quasi-contractual liability by reason of the same representations. The policy of the law is not subservient to ritual.

> "That a defendant, who could not by contract lawfully relieve himself from liability as a stockholder, can accomplish that result by proof that it was fraudulently represented to him that he could so relieve himself, would be strange indeed."
>
> *Upton* v. *Tribilcock*, 91 U. S. 45, 50.

POINT II.

The decision of the Circuit Court of Appeals is erroneous because it imposes liability upon the Bank for the misrepresentations of its officers in connection with the sale of shares of its corporate stock which were the property of the Harriman Securities Corporation, a separate company.

The stock sold to the plaintiff was owned by the Harriman Securities Corporation, a New York corporation organized for the purpose of purchasing, holding, selling and dealing in securities, and other investments (R. 90). The stock of the corporation was held by trustees, who were officers and directors of the Bank and each shareholder of the Bank had the "right to a beneficial interest through the Trustees in the capital stock of the Securities Company" (*do.*).

The Securities Corporation did "a large and substantial business in connection with securities of various kinds" (R. 37).

The district judge directed verdict for the Bank because it "was not enriched by reason of the sale of the Bank's stock to Mr. Oppenheimer" (R. 46).

Even if a contrary inference as to enrichment could have been drawn, the determination of the trial judge, to whom the drawing of inferences of fact was submitted by the motions for a directed verdict without request for leave to go to the jury, was conclusive.

> "Both sides moved for the direction of a verdict, and the trial judge became by consent the trier of the facts. If conflicting inferences were possible he chose those favorable to the plaintiff."
>
> *De Cicco* v. *Schweizer,* 221 N. Y. 431, 439.

In *Jaskow* v. *Harriman Nat. Bank & Trust Company,* 159 Misc. (N. Y.) 39, the plaintiff sued to recover the sum of $3,030 as damages by reason of his purchase of two shares of the stock of the Harriman National Bank and Trust Company from the Bank, claiming that such purchase had been induced by false representations made by a vice president of the Bank.

The trial judge found that the stock was purchased by the plaintiff in the belief that he was purchasing it from the Bank and not from the Harriman Securities Corporation and that the stock was purchased in reliance upon false and fraudulent representations made by persons who were officers of the Bank and also officers of the affiliate. Verdict was directed in favor of the defendants. From the opinion of the trial court, we quote the following:

> "Plaintiff contends that the sale was made by the bank as principal and that the bank received the proceeds or consideration thereof. On the record before me and within the period during which evidence as to the transactions was received, that is, from January to July, 1931, I reach the conclusion that the plaintiff has failed to sustain the burden of proof to establish that contention. * * *
>
> * * * * * * *
>
> "The purported sale of the stock by the bank and the representations by the persons who were bank officers in respect to the value of its shares were wholly unauthorized, and as against bank depositors and other creditors who concededly had nothing to do with the sale or the fraud in connection therewith, a bank stockholder should not on principle be allowed to recover, unless

the consideration of the sale passed to the bank itself. The receipt of the proceeds is the only conceivable ratification of the transaction by the bank and this is the basis on which plaintiff in his bill of particulars sought to establish such ratification.

"It can never be assumed that an officer of a national bank had authority to transact business in which the bank, by its charter (as restricted by the Banking Act), was expressly prohibited from engaging (*Alexander* v. *Cauldwell,* 83 N. Y. 480, 486). The prohibitions of the act are primarily for the security of national banking institutions, that is, for the protection of depositors and other creditors; and if the bank has not received the proceeds of the unauthorized transaction the loss should not be inflicted upon it with the consequent impairment of financial responsibility.

"It has been repeatedly held that a national bank, contracting beyond its powers, is not liable for anything beyond what is received (*Jackman* v. *Continental National Bank,* 16 F. (2d) 728; *Merchants Bank* v. *State Bank,* 10 Wall 604, and numerous other cases cited; U. S. Code Ann., tit. 12, Banks and Banking, §24, note 145). Assuming, therefore, that the bank, acting through its officers, did itself purport to sell the stock (instead of being a conduit through which the company sold it, as I find on this record), the public policy of the National Banking Act, aimed to protect depositors, would forbid recovery by a defrauded purchaser of the stock as against the bank, unless the bank, with the knowledge of the fraud, retained the proceeds of the sale.

* * * * * * *

"Plaintiff has, of course, a good cause of action against the individual officers who perpetrated

the fraud, but it is against them as individuals and not as officers of the bank."

Jaskow v. *Harriman Nat. Bank & Trust Co.*, 159 Misc. 39, 40-42.

The foregoing opinion by Justice Dore, was followed by the district judge in the instant case (R. 46).

To the same effect:

Heitman v. *Harriman*, 14 F. Supp. 282 (D. C., S. D. N. Y.).

Examination of the record in *Bradley* v. *Harriman National Bank & Trust Company of the City of New York*, 247 App. Div. 876, will disclose a state of facts similar to that in the *Jaskow* case. The memorandum by the Appellate Division is as follows:

"Action to recover $7,560 as damages for alleged fraud in the sale to plaintiff of five shares of stock of defendant bank. Judgment dismissing the complaint at the close of case unanimously affirmed, with costs. No opinion. Present—Martin, *P. J.*, McAvoy, O'Malley, Townley and Glennon, *J. J.*"

After affirmance by the Appellate Division, application was made to that court for leave to appeal to the Court of Appeals and was denied (248 App. Div. 564). Likewise, application to the Court of Appeals for leave to appeal was denied (271 N. Y. 663).

The foregoing decisions defeating attempts to charge this Bank with liability for the frauds of its officers proceed, as we have seen, on findings that the shares sold to the defrauded stockholders were not the property of the Bank, that the Bank was not enriched by the proceeds of the sales, and that the Bank's officers could not bind the Bank.

See also:

Farmers' State Guaranty Bank v. *Cromwell,* 70 Okla. 190, 173 Pac. 826; citing *U. S.* v. *Bank of Columbus,* 21 How. 356; Morse on Banks and Banking, 6th Ed., §132.

Since the Bank in the instant case, did not receive the avails of the sale of the stock, it is not chargeable with ratification of the transaction. Any liability on its part for the representations made by its officers must, therefore, rest upon the assumption, in which the Circuit Court of Appeals indulges, that the officers, because they were the selling instrumentalities, had authority to bind the Bank by any representations which they might make when the stock was sold.

We have urged, under the first point, that the Bank could not bind itself by such representations, since to permit it to do so would violate the cited sections of the law relating to Banks and Banking. But even if it were permissible for the Bank by an appropriate grant of actual authority to empower its officers to make representations binding the Bank, the mere fact that representations are made by the president or vice-president imports neither actual nor apparent authority to make them. Any other doctrine would be fraught with serious consequences to the creditors and stockholders of a bank.

Power to sell bank stock does not confer implied authority to warrant.

In *Smith* v. *Tracy,* 36 N. Y. 79, an attempt was made to charge the owner of bank stock with liability for the representations of the president of the bank with whom the owner had left the stock for sale. Judgment in favor of the plaintiff was reversed by the Court of Appeals on the ground that the presi-

dent of the bank had no authority to warrant the stock which the owner had empowered him merely to sell, the property, bank stock, being of a description not usually sold with warranty.

See also:

Cafre v. *Lockwood,* 22 App. Div. 11;
Oppenheimer v. *Irvin,* 166 App. Div. 233.

There is no reason for applying a different rule to representations than that which pertains to warranties. The elements which give rise to the right of rescission based upon false representations of fact are, in addition to the falsity, the materiality of the statement, intent that it should be acted upon, and action in reliance upon it with consequent injury. In all essentials such representation constitutes, by definition, an express warranty.

> "Any affirmation of fact or any promise by the seller relating to the goods is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon."

N. Y. Personal Property Law, §93.

The same words, uttered in the same manner and under the same circumstances, constitute, if false, both a breach of warranty and a fraudulent representation, so far as concerns the right to rescind and recover what was paid on the rescinded transaction.

It would seem to follow, therefore, that no representation may be inferred when the right to warrant can not be implied.

POINT III.

The decision of the Circuit Court of Appeals is erroneous because it directs that a claim founded upon the fraud of national bank officers in inducing the person defrauded to purchase shares of the bank's stock shall participate in the proceeds of an assessment collected from the other shareholders.

The Bank is not a going concern. It is in receivership and, since March 3, 1933, has been insolvent (R. 34). The Comptroller of the Currency has levied an assessment against the stockholders in the full amount provided for by Title 12 U. S. C., §64 (R. 38-39).

The Circuit Court of Appeals has directed that plaintiff have judgment against the Bank for the amount demanded in the complaint "collectible out of the assets of the receivership after payment in full of all who were creditors when the said bank became insolvent" (R. 132-133).

The recovery so directed will of necessity come out of collections from the stockholders. It cannot come out of the assets of the Bank, since the Bank is insolvent. In substance and effect, the decision of the Circuit Court of Appeals makes the stockholders of the Bank liable to satisfy plaintiff's claim out of the assessment which they are required to pay.

We are now to inquire whether there is anything in Title 12, U. S. C., §64, providing for assessments on shareholders that justifies the ruling by the Circuit Court of Appeals. That section is as follows:

> "§64. *Individual liability of shareholder; transfer of shares.* The stockholders of every national banking association shall be held individually responsible for all contracts, debts, and

> engagements of such association, each to the amount of his stock therein, at the par value thereof in addition to the amount invested in such stock. The stockholders in any national banking association who shall have transferred their shares or registered the transfer thereof within sixty days next before the date of the failure of such association to meet its obligations, or with knowledge of such impending failure, shall be liable to the same extent as if they had made no such transfer, to the extent that the subsequent transferee fails to meet such liability; but this provision shall not be construed to affect in any way any recourse which such shareholders might otherwise have against those in whose names such shares are registered at the time of such failure (Dec. 23, 1913, c. 6, §23, 38 Stat. 273)."

Since the liability of the shareholders is imposed by the statute, anyone asserting a right to share in the proceeds of the assessment must prove that his claim is one for which the shareholders are responsible. Whether the liability imposed on the shareholders be regarded as statutory or contractual, certainly it may not include risks which neither the statute contemplated nor the stockholders have undertaken. The claim asserted by the plaintiff in this action is not a contract, debt or engagement of the Bank. It is not, therefore, within the compass of the statute creating the double liability of stockholders.

In *Clinton Mining & Mineral Co.* v. *Beacom,* 266 F. 621 (C. C. A. 3), petition for writ of certiorari denied, 254 U. S. 637, an action was brought by a judgment-creditor of a South Dakota corporation against a stockholder of that corporation to enforce

the stockholder's statutory liability for debts of the corporation. It was held that the defendant might go behind the judgment and if it had been obtained on a claim which was not comprised within the statutory liability the judgment-creditor could not recover against the stockholder because the latter's liability depended on the nature of the claim against the corporation on which the judgment was founded.

In that case there was no such statutory context as results from the use in Title 12, U. S. C., §64, of the word "debts" between "contracts" and "engagements", indicating, under the principle of *noscitur a sociis* that "debts" must be construed as obligations analogous to those arising out of contracts and engagements.

The language of the South Dakota statute was:

> "Each stockholder of a corporation is individually and personally liable for the debts of the corporation to the extent of the amount that is unpaid upon the stock held by him."

The judgment-creditor who sought to collect the statutory liability from the stockholder had recovered a judgment in an action of tort against the corporation in which the defendant held stock. The Circuit Court of Appeals, in affirming judgment of nonsuit, wrote as follows (p. 623):

> "In legal dictionaries defining the word 'debt', the consensus of definition is to give the technical meaning of certainty of amount as the earmark of a debt, and to contrast its specific promise by contract, with the uncertainty of general words such as 'obligation', 'liability', and the like. But not only does the word 'debt' carry with it the requirement of certainty, and the foundation of

promise by express contract, but it necessarily implies legality, since the basis of its obligation is legality based on promise and lawful consideration, and hence it will be seen that, a debt being in its nature certain, contractual, and lawfully incurred; it is reasonable that a statute should enact that a stockholder should be held liable for debts a corporation would properly and legally incur. From all of which it would clearly appear that both from the uncertainty and indefiniteness of uncontracted for liability, and from the illegality and wrong from which it arises, that a tort or wrong on the part of a corporation stands in a wholly different relation to a stockholder than does a debt with its certainty of contract and its legality of consideration.

"The corporation has no right to commit such tort or wrong. When the stockholder subscribed for its stock, it was not with the purpose of creating an agency that should commit a tort or wrong. Such acts were not incident to purposes for which it was formed, nor was the liability for such wrong which inured to the one wronged thereby, a right for which the latter bargained in the course of what the corporation was impliedly authorized by the stockholder to do. On the contrary, the wrong done was a wrong illegally done by the corporation, not only to the third party, but a wrong done equally and illegally to its stockholder. Such being the case, he who would make the word 'debt' in this statute a synonym for tort, and thereby impose liability on the stockholder, is giving the word 'debt' an effect which usage does not warrant nor reason justify. We are therefore of opinion that the tort of which the milling company was guilty in unlawfully mining the plaintiff's ore, was not a debt of the tort-feasor corporation, for which its stockholders were made personally liable by this statute."

See also

Chase v. *Curtis,* 113 U. S. 452;
Brown v. *Trail,* 89 Fed. 641;
Bohn v. *Brown,* 33 Mich. 257.

It is our submission that a claim founded upon the fraud of national bank officers in inducing the person defrauded to purchase shares of the bank's stock does not come within "contracts, debts, and engagements" within the meaning of Title 12 U. S. C., §64.

It is well established that the contracts, debts, and engagements referred to in the statute imposing double liability include only such contracts, debts, and engagements as have been duly contracted in the ordinary course of its business. It does not include any liability to satisfy a claim asserted after the bank has ceased to do business.

Richmond v. *Irons,* 121 U. S. 27;
Schrader v. *Manufacturers' Bank,* 133 U. S. 67.

Nor does it include any obligation resulting from a transaction which was *ultra vires* the bank.

Ward v. *Joslin,* 186 U. S. 142;
Close v. *Potter,* 155 N. Y. 145;
First National Bank v. *Ocean National Bank,* 60 N. Y. 278.

In *Assets Realization Co.* v. *Howard,* 70 Misc. (N. Y.) 651 (affd. 152 App. Div. 900, for grounds of affirmance in Court of Appeals, see 211 N. Y. 430), the court said (p. 671):

> "The rules of law laid down and enunciated in the above cases,* so far as we have been able to discover, have nowhere been questioned. They

* *Ward* v. *Joslin,* 186 U. S. 142, and *Close* v. *Potter,* 155 N. Y. 145, *supra,* among others.

are founded in common sense and supported by the best of reasons.

"Corporate officers are but the agents of the corporation and, in a sense, of the stockholders, whose capital is invested in the enterprise. They get their authority to act and bind the corporation and its stockholders from the statute which authorizes the corporate existence. When the directors or officers of a corporation go beyond the powers and authority conferred, they cease to represent the stockholders, and their acts ought not to create any liability on the stockholder for such *ultra vires* transactions."

It is settled law in England that no shareholder of a corporation who has been induced to purchase his shares by the fraud of its officers may, after it has become insolvent and gone into liquidation, either rescind his purchase or maintain an action for damages for the deceit. The reason is that in either case his recovery must come out of the contributions of the other shareholders who are equally innocent of the fraud.

The Companies Act, 1862 (25 and 26 Victoria, p. 614), contained a provision, Section 38, that made every present and past member of a company formed under the act liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities. The City of Glasgow Bank was incorporated under the Companies Act, 1862. One Houldsworth purchased £4,000 of the bank stock from the bank itself in February, 1877, at the price of £9,000. He was registered and received dividends. The bank went into liquidation in October, 1878, with immense liabilities and Houldsworth, as did the respondent in the case at bar, paid an assessment. He brought an action against the liquidators (cor-

responding to the receiver under our system) to recover damages in respect of the sums he had paid originally for the stock and on the first call by the liquidators, and in respect of the estimated future calls. He founded his claim upon the ground of fraudulent misrepresentations made by the directors and other bank officials to him. The Court of Session in Scotland dismissed his action. He appealed to the House of Lords. The House of Lords affirmed the judgment. The following are from the opinions of the Law Peers:

> "Such an action of damages as the present is really not against the corporation as an aggregate body, but is against all the members of it except one, viz., the Pursuer; it is to throw upon them the Pursuer's share of the corporate debts and liabilities. Many of those shareholders (as was observed by Lord Cranworth in *Addie's Case* [L. R. 1 H. L., Sc. 145]) may have come and probably did come into the company after the Pursuer had acquired his shares. They are all as innocent of the fraud as the Pursuer himself; if it were imputable to them it must, on the same principle, be imputable to Pursuer himself as long as he remains a shareholder; and they are no more liable for any consequences of fraudulent or other wrongful acts of the company's agent than he is. Rescission of the contract in such a case is the only remedy for which there is any precedent, and it is in my opinion the only way in which the company could justly be made answerable for a fraud of this kind. But for rescission the Appellant is confessedly too late."
>
> Lord Selborne in *Houldsworth* v. *City of Glasgow Bank and Liquidators*, 5 App. Cas. 317, 329-30.

The very relief granted to the respondent in the instant case by the Circuit Court of Appeals was suggested in the lower court in the *Houldsworth* case and is thus dealt with by the Lord Chancellor (Earl Cairns):

> "It appears to have been contended in the Court below that the Appellant might be unable to maintain the present action as a claim in the liquidation to be satisfied *pari passu* with other creditors, and yet might be able to maintain it as a claim against the company or against shareholders in the company after all other creditors were satisfied. In the argument at your Lordships' Bar I think it was felt to be impossible to maintain this theory of a deferred or secondary right of action against the company. I am satisfied there is no foundation for it. *The Winding-up Act* has no provisions for the payment of claims against the company except the claims of creditors. Creditors are supposed to be paid *pari passu,* and there is no provision after they are paid for opening up fresh claims by a contributory against the company. There are, indeed, provisions which, after the debts are paid, enable any inequalities in the contributions of the contributories to be set right, but that is quite a different matter."
>
> *Houldsworth* v. *City of Glasgow Bank and Liquidators,* 5 App. Cas. 317, at page 323.

At the beginning of the Lord Chancellor's opinion, he dealt with the fundamental question whether there could be repudiation of the stock after insolvency:

> "It was admitted before your Lordships, as indeed it could not be denied, that after the

winding-up of the company commenced it was too late for the appellant to repudiate his stock, and that he must remain, as the liquidation found him, a partner in the bank and a contributory as such" (do., pp. 322-323).

In the same case, Lord Hatherley expressed views on a situation with which the court was there concerned in all respects analogous to that involved in the instant case as follows:

"In truth the appellant is trying to reconcile two inconsistent positions, namely, that of shareholder and that of creditor of the whole body of shareholders including himself. As has been observed already by those of your Lordships who have preceded me, amongst the various cases which have been brought before the Courts in respect of dealings with joint stock companies, no case can be adduced in which a person so claiming to be a shareholder has at the same time successfully asserted his claim against a company in liquidation for such a debt as this, namely one in which he is himself a co-debtor with all his fellow shareholders to himself, and is himself in common with them responsible again to them individually for like liabilities irrespective of representations made by their common agent" (do., pp. 333-4).

The principle stated in the *Houldsworth* case, *supra,* was applied by Sir George Jessel, Master of the Rolls, in *Re Hull and County Bank, Burgess's Case,* 15 Ch. Div. 507. There, a shareholder of a bank who had been induced by fraudulent misrepresentations contained in the prospectus to apply for shares attempted to rescind his contract and recover the sum paid for the shares after the bank had gone into liquidation.

The Master of the Rolls, holding that such a claim might not be successfully asserted, said (p. 512):

> "Now, the other shareholders are as innocent of this fraud as the applicant. There is no pretense for saying that they authorized the committal of it; on the contrary, they themselves were defrauded in like manner. Therefore, they acquired rights as innocent parties under the 38th section which this applicant seeks to take away from them. It is quite true that in *Oakes* v. *Turquand** the only persons whose rights were decided upon were creditors, but the rights of other persons equally innocent were not required to be considered, because there was not enough to pay the creditors.
>
> "In this case, however, it is said that the assets of the company contributed by the other shareholders are sufficient to pay the creditors in full and all costs, and, therefore, that, the creditors having been paid or provided for, those rights are not to be considered; but, as I said before, the other contributories are also innocent persons, and have acquired rights, and I see no reason why those rights should not be considered."

The Master of the Rolls further said (pp. 513-514):

> "Therefore, if you have paid for your shares, and your payment has been applied in the payment of creditors, and the other contributories have not fully paid, they being equally innocent, you would be entitled on that theory to claim back the sum you had paid, and to have it paid you by a call on the other contributories. Of course that would not be enforcing the adjustment of the rights of the contributories amongst themselves, because, as I said before, these other

* L. R. 2 H. L. 325.

contributories are not the persons who committed the fraud, and they are not liable, and, consequently, if you cannot have total rescission of the contract, it is plain you cannot have partial rescission either, and the claim must wholly fail."

See also:

East Broken Hills Consols., Ltd. v. *Mallaby-Deeley,* 11 T. L. R. 241, affd. id. 245.

It was error for the Circuit Court of Appeals to order that the plaintiff's claim should participate in the proceeds of an assessment collected from the shareholders.

POINT IV.

Plaintiff is barred after insolvency from rescinding his purchase of bank stock and particularly, as the rights of subsequent creditors have intervened.

Plaintiff purchased his stock in November, 1930 (R. 3). He received three semi-annual dividends thereafter (R. 15). Between the time of the purchase of his stock and the closing of the Bank new creditors came into the Bank in an amount exceeding $10,000,000 (R. 34), who have not been paid in full (R. 38). He did not attempt to rescind until May, 1933 (R. 18, 51-2), some months after the Bank had become insolvent and was closed (R. 34).

These facts bring the case within the rule stated by Sanborn, *C. J.* writing for the Circuit Court of Appeals, Eighth Circuit, in *Ratcliff* v. *Clendenin,* 232 Fed. 61, as follows (p. 64):

"A stockholder who is induced by fraud to purchase the stock of a corporation, and who for

> years, while the corporation is a going concern and is incurring debts to creditors, which still exist, receives dividends or income from his purchase of the stock, is estopped, after the corporation becomes insolvent, has ceased to be a going concern, and is adjudged a bankrupt, from rescinding his purchase of the stock against a protest of its creditors [Citing numerous authorities]."

So, in *Bittenbender* v. *Cosmopolitan Trust Co.*, 253 Mass. 230, 148 N. E. 619, the Supreme Judicial Court of Massachusetts, by Chief Justice Rugg denied the claims of a defrauded stockholder of a bank, made after the insolvency of the bank, to be relieved from liability on his stock and to establish a constructive trust for the moneys paid by him, saying that although he could have had his remedy "while it was a going concern or before the rights of third persons had supervened, * * * at least to the extent of setting aside his subscriptions to stock on the ground of fraud and recovering the money he had paid", the commissioner of banks having taken possession of the company "the situation now has changed in a decisive particular" and the plaintiff "cannot establish a debt nor gain any priority as to funds in the hands of the commissioner of banks in possession of the trust company for purposes of liquidation."

In *Palmer* v. *Citizens' Bank of Murray*, 179 Ky. 54, 200 S. W. 41, the Court of Appeals of Kentucky said, of the rights of a defrauded stockholder:

> "He cannot obtain relief if the action is not commenced until the corporation has become insolvent, or until proceedings have been instituted for the liquidation of its affairs, unless he had become a stockholder so recently before

> the insolvency that he had not had reasonable time or opportunity to investigate its affairs and discover the fraud, and had not received any dividend or other return for his investment in the stock."

The Court further said that the reason for that rule was that, after insolvency of the company, the stockholder's

> "attempt to secure a rescission or damages for the fraud, which had been perpetrated upon him, would affect the rights of the creditors of the institution."

See also:

Wilson v. *Hundley,* 96 Va. 96, 30 S. E. 492;
Duffield v. *E. T. Barnum W. & I. Works,* 64 Mich. 293, 31 N. W. 310;
Farrar v. *Walker,* Fed. Cas. 4679.

POINT V.

Plaintiff is not entitled to a claim payable ratably with the claims of depositors and other creditors of the Bank.

The Circuit Court of Appeals, in the instant case, has permitted the plaintiff to rescind his purchase as against the corporation, but postponed payment of his claim until after payment in full of all who were creditors when the Bank became insolvent (R. 115-116).

Although the Circuit Court of Appeals should not have allowed any rescission either as against creditors or the other stockholders, it is our submission that if rescission is to be allowed against the corporation, the Circuit Court of Appeals was right in sub-

ordinating the claim of plaintiff to the claims of depositors and other creditors of the Bank.

The Circuit Court of Appeals declined to follow *Salter* v. *Williams,* 244 F. 126, where a defrauded stockholder was permitted to share *pari passu* with depositors in the distribution of a bank's assets in liquidation. "Obviously, one who is liable to such creditors as a stockholder for assessment can neither reduce the amount he has paid as assessment nor come in to share assets he is bound to leave to the prior satisfaction of those creditors. In so far as *Salter* v. *Williams,* 244 F. 126 (C. C. A. 3), teaches the contrary, it overlooks the necessary implication of the liability statute in the case of insolvent national banks and we cannot follow it" (R. 116).

The cogent public policy responsible for the enactment of 12 U. S. C. §64 imposing double liability on the shareholders of a national bank is reflected in the decision under appeal which seeks to guard the sacredness of the additional security afforded depositors, and it is realized that the conscious assumption of the statutory liability by the stockholder would be nullified by permitting him to share *pari passu* with the depositors.

The *Salter* case proceeds on the principle that Salter acquired the status of a creditor immediately upon the purchase of his shares. Thus the court stated that his right to rescind "was fixed by the fraud of the bank when the fraud was practiced", and that, therefore, he "approached the Receiver like an ordinary creditor whose claim was contracted before receivership" (244 F. 126, 130). A purchaser of stock who has not rescinded his purchase is not a creditor with a claim for the return of his money. Assuming that the transaction may be rescinded, the pur-

chase is voidable, not void. The purchaser may elect to rescind. He may not elect to rescind. He does not assume the status of creditor until he terminates his status of stockholder by exercising his election to rescind. Indeed, there is authority for the proposition that he does not become a creditor until his right to rescind has been adjudicated (*In re Harmony Creamery Co.,* 18 F. [2d] 609 [D. C. Pa.]), and it is indicated that he is entitled to interest on his claim only from the date of rescission (*Davis* v. *Louisville Trust Co.,* 181 Fed. 10, 23; *Hunsicker* v. *Gilham,* 163 La. 651, 112 So. 518; *Knight* v. *Bentel,* 39 Cal. A. 502, 179 Pac. 406).

The action for money had and received being quasi-contractual, based upon a promise implied in law (*Cary* v. *Curtis,* 3 How. 236, 250), it may be correct to say that the cause of action is based upon an implied contract made at the time of the sale. It by no means follows, however, that plaintiff's claim for the return of his money antedated insolvency. In the case of express contracts made before insolvency, it is well settled that claims for damages for non-performance may not share in the assets of the receivership where they do not mature until after insolvency.

In *Pink, as Superintendent of Insurance of the State of New York* v. *Harriman National Bank & Trust Company,* 247 App. Div. [N. Y.] 387, plaintiff asserted a claim in the liquidation of the Harriman Bank. The claim was for reimbursement for certain expenses incurred by a defunct insurance company in defending actions upon bonds issued to secure deposits in the bank. It was based upon an agreement made by the bank to save the insurance company harmless from any such expenses. The agreement was made before the bank became insolvent but the expenses were not incurred by the insurance

company until after insolvency. The Appellate Division of the Supreme Court, First Department, held that the claim was not entitled to share in the assets of the receivership. The court said (247 App. Div. [N. Y.] 387, at p. 389):

> "It is well settled that the only claims entitled to allowance in the liquidation of a national bank are those in existence on the date of the insolvency. In *Citizens' Bank & Trust Co.* v. *Thornton* (174 Fed. 752) the defendant was the receiver of a national bank. The bank had indorsed a promissory note which contained an agreement to pay costs and disbursements, including attorneys' fees, in litigation brought to enforce it. The note matured after the insolvency of the bank, and plaintiff sued the receiver. Plaintiff attempted to include in the judgment the costs of litigation, including attorneys' fees. The court held that this could not be done. (See, also, *Dunnagan* v. *Best,* 59 F. [2d] 795; *White* v. *Knox,* 111 U. S. 784; *Merrill* v. *National Bank of Jacksonville,* 173 id. 131.) The same rule has been established in the liquidation of New York State banks. (*Varick Spring Corp.* v. *Bank of United States,* 264 N. Y. 297.) Applying this principle to the facts herein, it is clear that the claim was rightly disallowed as one not matured at the date of insolvency."

The claim of a shareholder, who does not rescind his purchase until after insolvency, falls, we submit, within the same category. His claim does not come into existence until he elects to terminate his status of stockholder and assume, in substitution thereof, the status of creditor.

Moreover, the Circuit Court of Appeals was correct in deciding that the assessment statutes (12 U. S. C., §§ 64, 191, 192) by necessary implication, require the

denial of any relief in favor of the present plaintiff and against depositors and creditors of the bank. Plaintiff concedes that he remained liable for the assessment and he does not claim any right to a return of the assessment which he has paid. But the liability for assessment arises only if the individual assessed was a stockholder on the date of insolvency. Liability for assessment and right of rescission involve, therefore, a contradiction in terms. If a shareholder can obtain the return of his money upon the ground that he never properly became a stockholder, the conclusion would seem to be inescapable that he could, on the same basis, resist the assessment. *Merrill* v. *Florida Land & Improvement Company,* 52 F. 77, and 60 F. 17, carried the right of rescission to its logical conclusion by deciding that an injunction should issue against the collection of the stock assessment. It will scarcely be urged, however, that the decision was correct. *Scott* v. *De Weese,* 181 U. S. 202, and *Lantry* v. *Wallace,* 182 U. S. 536, foreclose further discussion of that question.

Plaintiff urges that he rescinded his purchase before the insolvency of the bank. The argument (Brief, pp. 8, 11, Point II [pp. 32-36]) is based upon two assertions, (1) that the concession of insolvency on March 3, 1933 (R. 34, 38) referred merely to insolvency in the sense of inability to pay debts as they matured on that day (implying that the kind of insolvency which bars the right of rescission is insolvency in the sense of an excess of liabilities over assets) and (2) that the right to rescind is not affected until the official declaration of insolvency implicit in the appointment of a receiver on October 16, 1933.

Although the record (R. 34, 38) does not substantiate the attempted qualification of the concession as to insolvency on March 3, 1933, it is unnecessary to

labor this phase of the argument. A conservator was appointed for the bank on March 13, 1933. The Bank Conservation Act (Title II of Act of March 9, 1933, c. 1, §203, 48 Stat. 2, 12 U. S. C. §203) provides:

> "Sec. 203. Whenever he shall deem it necessary in order to conserve the assets of any bank for the benefit of the depositors and other creditors thereof, the Comptroller of the Currency may appoint a conservator for such bank and require of him such bond and security as the Comptroller of the Currency deems proper. The conservator, under the direction of the Comptroller, shall take possession of the books, records, and assets of every description of such bank, and take such action as may be necessary to conserve the assets of such bank pending further disposition of its business as provided by law. Such conservator shall have all the rights, powers, and privileges now possessed by or hereafter given receivers of insolvent national banks and shall be subject to the obligations and penalties, not inconsistent with the provisions of this title, to which receivers are now or may hereafter become subject. *During the time that such conservator remains in possession of such bank, the rights of all parties with respect thereto shall, subject to the other provisions of this title, be the same as if a receiver had been appointed therefor.* All expenses of any such conservatorship shall be paid out of the assets of such bank and shall be a lien thereon which shall be prior to any other lien provided by this Act or otherwise. The conservator shall receive as salary an amount no greater than that paid to employees of the Federal Government for similar services." (Italics ours.)

No other provision in the title relates to the subject matter here in controversy.

It may further be noted that a bank differs from other corporations and individuals in so far as the status of insolvency is concerned. Other corporations and individuals are insolvent only when their assets are insufficient to meet their liabilities (under the bankruptcy laws), whereas banks are considered insolvent when they are unable to meet their current liabilities and the demands of customers over the counter in the ordinary course of business, notwithstanding there may be frozen assets which, together with other resources, may equal the liabilities. As stated in *Steele* v. *Randall,* 19 Fed. (2d) 40-41, "when the bank could not meet its obligations as they became due it was insolvent". (See also *Roberts* v. *Hill,* 24 Fed. 571, 573; *U. S.* v. *Oklahoma,* 261 U. S. 253, 261). It follows that the date of the appointment of the receiver was immaterial. (*Yardley* v. *Philler,* 167 U. S. 344; *Steele* v. *Randall, supra.*) Knowledge, intention, or motive on the part of the creditor is immaterial. *National Security Bank* v. *Butler,* 129 U. S. 223; *Roberts* v. *Hill, supra.*

Finally, a judgment admitting the claim of a defrauded shareholder to an equal ranking with the claims of depositors would seem to contravene the expressed solicitude of Congress for the claims of depositors of insolvent national banks. Congress, desiring to preserve from depletion the assets necessary to pay *depositors,* has provided that claims of the United States for taxes may not be asserted if the effect will be to diminish the assets necessary for the full payment of all depositors (12 U. S. C. Section 570, Act of March 1, 1879, c. 125, Section 22, 20 Stat. 351).*

"The act of 1879, divested of words not necessary to the consideration of this case, provides that when a bank has stopped business because of insolvency no tax shall be paid into the Treasury which shall diminish the assets 'necessary for the full payment of all its depositors', and such tax shall be abated from insolvent banks. No ambiguity appears in the statute; the taxes not to be paid are those only which shall diminish assets necessary to pay depositors; and the word 'such' in the concluding clause relates to the definition of the preceding clause, that is to those taxes, and to those only, whose payment will diminish the depositors' fund. This interpretation of the act has already been, in effect, given it in Johnston's Case, where the court says (p. 172):

> " 'The act of March 3, 1879, now under consideration, was passed for the undoubted purpose of relieving depositors in national banks from the payment of certain taxes not assessed upon them, but upon the banks of which they are only customers—taxes which, under the pre-existing law, they would indirectly be obliged to pay when a bank is so insolvent that all its capital is gone,

* Set forth in full in Appendix E herein, page 54.

and it has nothing left with which to pay taxes except the money of its depositors. These semi-annual taxes are assessed against national banks in their corporate capacity, upon their capital and business, in consideration of the franchise and benefits which the government grants to them, and for other reasons. They are expected to come out of the profits of the bank, and thus, reducing the dividends of the stockholders, they are a tax upon the proprietors of the institution.'

"It was clearly the intention of the statute to relieve the innocent customers of the bank, between whom and the government there were no relations of tax-payer and tax-receiver, and not to relieve the owners of the institution from their just liabilities."

Jackson, Receiver v. *United States,* 20 Ct. Cl. 298, at 304.

CONCLUSION.

Wherefore, it is submitted that the judgment of the Circuit Court of Appeals should be reversed and the judgment of the District Court affirmed.

Respectfully submitted,

MARTIN CONBOY,
Counsel for The Harriman National Bank and Trust Company of the City of New York.

GEORGE P. BARSE,
JOHN F. ANDERSON,
Attorneys for the Comptroller of the Currency,
Of Counsel.

APPENDICES.

A.

12 U. S. C., §51.

§51. *Requisite of capital and surplus.* After June 16, 1933, no national banking association shall be organized with a less capital than $100,000, except that such associations with a capital of not less than $50,000 may be organized in any place the population of which does not exceed six thousand inhabitants. No such association shall be organized in a city the population of which exceeds fifty thousand persons with a capital of less than $200,000, except that in the outlying districts of such a city where the State laws permit the organization of State banks with a capital of $100,000 or less, national banking associations now organized or hereafter organized may, with the approval of the Comptroller of the Currency, have a capital of not less than $100,000. No such association shall hereafter be authorized to commence the business of making until it shall have a paid-in surplus equal to 20 per centum of its capital: *Provided,* That the Comptroller of the Currency may waive this requirement as to a State bank converting into a national banking association, but each such State bank which is converted into a national banking association shall, before the declaration of a dividend on its shares of common stock, carry not less than one-half part of its net profits of the preceding half year to its surplus fund until it shall have a surplus equal to 20 per centum of its capital: *Provided,* That for the purposes of this section any amounts paid into a fund for the retirement of any preferred stock of any such converted State bank out of its net

earnings for such half-year period shall be deemed to be an addition to its surplus fund if, upon the retirement of such preferred stock, the amount so paid into such retirement fund for such period may then properly be carried to surplus. In any such case the converted State bank shall be obligated to transfer to surplus the amount so paid into such retirement fund for such period on account of the preferred stock as such stock is retired. (As amended Feb. 25, 1927, c. 191, §4, 44 Stat. 1227; June 16, 1933, c. 89, §17 (a), 48 Stat. 185; Aug. 23, 1935, c. 614, §309, 49 Stat. 709.)

B.

12 U. S. C. §51c.

§51c. *"Common stock," "capital" and "capital stock" defined.* The term "common stock" as used in sections 51a to 51d of this title means stock of national banking associations other than preferred stock issued under the provisions of sections 51a to 51d of this title. The term "capital" as used in provisions of law relating to the capital of national banking associations shall mean the amount of unimpaired common stock plus the amount of preferred stock outstanding and unimpaired; and the term "capital stock", as used in sections 101 and 177 of this title, shall mean only the amount of common stock outstanding. (Mar. 9, 1933, c. 1, §303, 48 Stat. 5.)

C.

12 U. S. C. §53.

§53. *When capital stock paid in; installments; proof.* At least 50 per centum of the capital stock of

every association shall be paid in before it shall be authorized to commence business; and the remainder of the capital stock of such association shall be paid in installments of at least 10 per centum each, on the whole amount of the capital, as frequently as one installment at the end of each succeeding month from the time it shall be authorized by the Comptroller of the Currency to commence business; and the payment of each installment shall be certified to the comptroller, under oath, by the president or cashier of the association. (R. S. §5140.)

D.

12 U. S. C. §54.

§54. *Failure to pay installments; remedy; effect if reduction of capital results.* Whenever any shareholder, or his assignee, fails to pay any installment on the stock when the same is required by the preceding section to be paid, the directors of such association may sell the stock of such delinquent shareholder at public auction, having given three weeks' previous notice thereof in a newspaper published and of general circulation in the city or county where the association is located, or, if no newspaper is published in said city or county, then in a newspaper published nearest thereto, to any person who will pay the highest price therefor, to be not less than the amount then due thereon, with the expenses of advertisement and sale; and the excess, if any, shall be paid to the delinquent shareholder. If no bidder can be found who will pay for such stock the amount due thereon to the association, and the cost of advertisement and sale, the amount previously paid shall be forfeited to the association, and such stock shall be sold as the

directors may order, within six months from the time of such forfeiture, and if not sold it shall be canceled and deducted from the capital stock of the association. If any such cancellation and reduction shall reduce the capital of the association below the minimum of capital required by law, the capital stock shall, within thirty days from the date of such cancellation, be increased to the required amount; in default of which a receiver may be appointed, according to the provisions of section 192 of this title, to close up the business of the association. (R. S. §5141.)

E.

12 U. S. C. §570.

§570. *Insolvent Banks as Exempt from Tax.* Whenever and after any bank has ceased to do business by reason of insolvency or bankruptcy, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank, which shall diminish the assets thereof necessary for the full payment of all its depositors; and such tax shall be abated from such national banks as are found by the Comptroller of the Currency to be insolvent; and the Commissioner of Internal Revenue, when the facts shall so appear to him, is authorized to remit so much of said tax against insolvent State and savings banks as shall be found to affect the claims of their depositors. (Mar. 1, 1879, c. 125, §22, 20 Stat. 351.)